Supreme Court, U.S.
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No. _____

In the Supreme Court of the United States

NANCY J. HUKKANEN-CAMPBELL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Tenth Circuit erred in holding, in conflict with the Fifth, Sixth, and Eleventh Circuits, that contingent attorneys' fees paid by a defendant directly to the attorneys of a prevailing plaintiff under Title VII of the Civil Rights Act of 1964 constitute taxable income to the plaintiff, thereby triggering alternative minimum tax liability.

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PETITION FOR A WRIT OF CERTIORARI

Nancy J. Hukkanen-Campbell respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-5a) is reported at 274 F.3d 1312. The opinion of the United States Tax Court (App., *infra*, 6a-18a) is a memorandum decision, T.C. Memo. 2000-180 (June 12, 2000), not officially reported, but available at 79 T.C.M. (CCH) 2122 (2000).

JURISDICTION

The judgment of the court of appeals was entered on December 19, 2001. App., *infra*, 1a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

The principal federal statute involved in this case is section 61(a) of the Internal Revenue Code of 1986, as amended and in effect in 1993 (the "Code"):

> (a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
> (2) Gross income derived from business;
> (3) Gains derived from dealings in property;
> (4) Interest;
> (5) Rents;

(6) Royalties;
(7) Dividends;
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

26 U.S.C. § 61(a). This case also tangentially involves the alternative minimum tax provisions of the Code, 26 U.S.C. §§ 55-59, and the fee-shifting provisions of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(k).

STATEMENT OF THE CASE

This case presents a recurring question of significant importance in the tax law. It involves the 1993 Federal income tax liability of Petitioner Nancy J. Hukkanen-Campbell ("Ms. Hukkanen") on amounts paid by her former employer in connection with Ms. Hukkanen's successful sexual harassment lawsuit brought under Title VII of the Civil Rights Act of 1964. The outcome of this case affects a broad class of taxpayers that includes a large number of individual plaintiff-taxpayers who prevail in lawsuits that give rise to substantial taxable recoveries and attorney's fees.

A. Factual Background

From 1981 to 1984, Ms. Hukkanen was subjected to sexual harassment on a regular basis by her former employer. Ex. 5-J

at 47.[1/] After filing a complaint with the Equal Employment Opportunity Commission ("EEOC"), Ms. Hukkanen retained attorney Fred Petzold and three other attorneys through a contingent fee agreement, under which the attorneys were entitled to receive the greater of (a) 45 percent of the recovery, (b) $125 per hour, or (c) any court awarded fee, plus costs. The contingent fee agreement also granted the attorneys a lien on the claim for the amounts payable to them under the agreement. App., *infra*, 8a; Ex. 8-J at 285.

Ms. Hukkanen obtained a "right-to-sue" letter from the EEOC in February 1990, soon after retaining her attorneys and being informed that she could request such a letter. Ex. 8-J at 286. Mr. Petzold filed a complaint on Ms. Hukkanen's behalf with the District Court for the Western District of Missouri, alleging that she was constructively discharged from her employment in violation of Title VII of the Civil Rights Act of 1964, Pub. L. No. 88-352, § 701 *et seq.* ("Title VII"). Ex. 4-J.

After a bench trial on February 13, 1992 and a hearing on March 31, 1992, the district court found that the sexual harassment had resulted in Ms. Hukkanen's constructive termination in violation of Title VII. Ex. 5-J at 45-52. On April 3, 1992, the district court entered its Final Judgment, awarding Ms. Hukkanen: (1) $55,492 in back pay; (2) $82,534.81 in pension benefits; and (3) $44,418.06 in front pay. App., *infra*, 7a; Ex. 6-J at 1-2.

The district court also awarded "a reasonable attorney's fee" in the amount of $85,227.50 pursuant to the fee-shifting provision of Title VII, 42 U.S.C. § 2000e-5(k). This award included a multiplier of three times the lodestar amount "to

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1 References to "Ex." are to the Tax Court joint exhibits, which were part of the record on appeal to the Tenth Circuit.

compensate plaintiff's attorney for the risk incurred by him in agreeing to represent [Ms. Hukkanen] and pursuing her claim with only a contingent fee arrangement." Ex. 6-J at 2. The Court of Appeals for the Eight Circuit affirmed the district court's decision in all respects, except that it reversed the district court's enhancement for risk of loss of the attorneys' fees portion of the award. Ex. 8-J at 287.

On December 21, 1993, the defendant in Ms. Hukkanen's Title VII action paid $150,000 in partial satisfaction of that judgment, issuing a check in that amount payable to Ms. Hukkanen and two of her attorneys. Ms. Hukkanen and her attorneys executed a schedule detailing the disbursement of the $150,000 payment. The total disbursed to Ms. Hukkanen's attorneys was $73,399.25. She received the remainder, $76,600.75. App., *infra*, 1a; Ex. 9-J.

B. Tax Treatment and Statutory Background

Ms. Hukkanen timely filed her 1993 Federal income tax return and paid $20,075 in tax on the $76,601 she received.[2/] On April 16, 1998, the Commissioner of Internal Revenue issued a statutory notice of deficiency ("Notice") to Ms. Hukkanen. The Notice determined a deficiency of $17,402 in her 1993 taxable year attributable to the operation of the alternative minimum tax. App., *infra*, 2a.

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2 Ms. Hukkanen calculated her tax due by reporting the $150,000 as income and deducting the $73,399 in attorneys' fees in full, which, in the absence of the alternative minimum tax, is the functional equivalent of reporting only the $76,601 she received. The $20,075 in tax she paid on that $76,601 can be calculated by subtracting the tax she calculated to be due on an amended return she later filed (Ex. 2-J), which excluded the lawsuit proceeds from her income entirely, from the tax she calculated to be due on her original return (Ex. 1-J).

The alternative minimum tax, 26 U.S.C. §§ 55-59, applies to taxpayers whose "alternative minimum taxable income" exceeds an exemption amount. 26 U.S.C. § 55(b)(1)(A). "Alternative minimum taxable income" is defined as "taxable income" reduced by only a limited list of deductions. 26 U.S.C. § 55(b)(2). One category of deductions not allowed in computing alternative minimum taxable income is "miscellaneous itemized deductions"—a "catch-all" category. 26 U.S.C. §§ 56(b)(1)(A)(i), 67(b). Deductions for attorney's fees paid fall into this disallowed category.

The alternative minimum tax therefore only applies to the extent a taxpayer receives "taxable income." "Taxable income" is defined in the Code as "gross income" less certain deductions. 26 U.S.C. § 63(a). "Gross income" is defined generally as "all income from whatever source derived." 26 U.S.C. § 61(a).

The Commissioner of Internal Revenue's Notice treated the entire $150,000 paid by the Title VII defendant as taxable income to Ms. Hukkanen, and disallowed most of the deduction for attorneys' fees paid pursuant to the alternative minimum tax provisions outlined above. Ex. 3-J. The amount of tax Ms. Hukkanen paid upon filing her original 1993 Federal income tax return was the same as that which would be calculated by including only the $76,601 she actually received in her income.

The operation of the detailed statutory provisions of the alternative minimum tax has never been disputed. Rather, the point of disagreement between Ms. Hukkanen and the Internal Revenue Service was, and continues to be, whether the $73,399 of the Title VII defendant's $150,000 payment retained by Ms. Hukkanen's attorneys constitutes "income" to her under 26 U.S.C. § 61(a).

C. Proceedings Below

On July 13, 1998, Ms. Hukkanen timely petitioned the United States Tax Court to review the deficiency in tax asserted in the Notice.[3] The Tax Court upheld the deficiency, issuing an opinion on June 12, 2000 (App., *infra*, 6a-18a) and entered its decision in favor of the Commissioner of Internal Revenue on June 13, 2000. Ms. Hukkanen filed a timely notice of appeal from that decision on September 8, 2000.[4] App., *infra*, 2a.

A panel of the Tenth Circuit affirmed the Tax Court's decision in a published opinion issued December 19, 2001. The court summarily concluded that "[t]he $150,000 [Ms. Hukkanen] recovered in her Title VII suit clearly constitutes income from 'whatever source derived.'" *Ibid.* While the court cited the decisions of the three circuit courts of appeals that have reached the opposite result, it noted that "the majority of the circuits have rejected" the argument that contingent attorneys' fees paid directly to attorneys do not constitute income to those attorneys' clients, citing decisions of four circuits holding against taxpayers on this issue. *Id.* at 3a.

The Tenth Circuit distinguished two of the three conflicting circuit decisions[5] based upon perceived, but

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3 The Tax Court had jurisdiction to review the asserted deficiency pursuant to 26 U.S.C. §§ 6123(a), 6214(a) and 7742.

4 The Tenth Circuit had jurisdiction under 26 U.S.C. § 7482(a)(1). App., *infra*, 2a.

5 The Tenth Circuit declined to follow the other contrary circuit court of appeals decision holding in favor of taxpayers on this issue, a recent decision of the Fifth Circuit, based on (a) that court's statement that it was bound by previous precedent and was not deciding the case as an original matter; and (b) purportedly widespread criticism of the decision, citing

unarticulated, differences in the applicable State attorney lien statutes (*ibid.*), but also stated that "[t]he Tax Code mandates this result [*i.e.*, inclusion of the attorneys' fees in the plaintiff's income] irrespective of a particular state's attorney lien statute's provisions." *Id.* at 4a. The court agreed with Ms. Hukkanen "that a universal standard independent of the 'intricacies of any attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." However, contrary to Ms. Hukkanen's arguments, the Tenth Circuit concluded that the Code required inclusion of the attorneys' fees in Ms. Hukkanen's taxable income. *Ibid.*

REASONS FOR GRANTING THE PETITION

This Court should review the Tenth Circuit's decision because the circuits are split over the recurring issue of whether contingent attorneys' fees paid by a defendant to the attorneys of a prevailing Title VII plaintiff constitute taxable income to the plaintiff, and because the Tenth Circuit's analysis is inconsistent with this Court's decisions defining the scope of the term "income" in the Code.

In determining that the attorneys' fees paid to Ms. Hukkanen's attorneys constitute income to her, the Tenth Circuit failed to apply the extensive framework for determining the boundaries of taxable "income" developed in decades of decisions of this Court and inferior courts. Under those decisions, only income that is sufficiently within a taxpayer's dominion and control can be charged to the taxpayer as income.

The contingent attorneys' fees in this case were outside of Ms. Hukkanen's control. She did not receive the attorneys'

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one law review article. App., *infra*, at 4a.

fees portion of the judgment, nor could she ever have received it. Rather, the attorneys' fees portion of the Title VII award was properly taxable to her attorneys, who had an undisputed right to the proceeds, and who were the principal force behind the generation of that income. The Tenth Circuit erred in deviating from the well-established tests for allocating income to he who earned it. A proper application of those tests to the issue raised by Ms. Hukkanen's case results in the appropriate outcome—that reached by the Fifth, Sixth, and Eleventh Circuits—that the attorneys' fees paid by the Title VII defendant directly to her attorneys are not income to Ms. Hukkanen.

I. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS OVER THE TAX STATUS OF CONTINGENT ATTORNEY'S FEES AS INCOME TO THE ATTORNEY'S CLIENT.

The Tenth Circuit's opinion cites the decisions of three circuits holding that contingent attorney's fees do not constitute income to a successful plaintiff. App., *infra*, 3a. The Tenth Circuit, however, declined to follow those decisions, opting instead to adopt the position of other circuits charging income to plaintiffs whose attorneys are paid directly by lawsuit defendant. *Ibid.* As a result of the split among the circuits recognized by the Tenth Circuit, a taxpayer's liability for Federal income tax varies depending upon the circuit in which she resides at the time she files a Tax Court petition.[6] This Court should resolve this conflict among the circuits to

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6 The circuit in which a taxpayer resides at the time she files a petition with the Tax Court determines the circuit court of appeals where venue is appropriate for an appeal of the Tax Court's decision. 26 U.S.C. § 7482(b)(1)(A). The Tax Court applies the law of the circuit to which an appeal lies under the "*Golsen* doctrine." See *Golsen v. Commissioner*, 54 T.C. 742, 756-757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

promote uniformity in the application of the Federal income tax laws and to discourage forum shopping.

A. The Tenth Circuit's Decision in this Case Directly Conflicts With Recent Decisions of the Fifth, Sixth, and Eleventh Circuits.

1. Circuits reaching the opposite conclusion to that of the Tenth Circuit

The first case to address whether contingent attorney's fees constitute income to the attorney's client was *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959). In *Cotnam*, the plaintiff, Mrs. Cotnam, successfully sued the estate of T. Shannon Hunter, who had promised her one-fifth of his estate in exchange for her services as his attendant for the remainder of his life. Mrs. Cotnam was awarded $120,000, of which she paid $50,365.83, representing a 40 percent contingent fee, plus costs, to her attorneys. *Id.* at 120.

The Fifth Circuit held that the $50,365.83 in attorneys' fees was income to the attorneys, but not to Mrs. Cotnam. 263 F.2d at 125-126. As a result, Mrs. Cotnam was taxable only on the net amount of her award. The court explained:

> The only income, the only real economic benefit, which Mrs. Cotnam ever received was the $75,254.17 which she collected. (In our opinion, it is as illegal as it is unjust to tax her on the remaining $50,365.83 which did not pass through her hands and of which she never had control.) In a realistic sense the remaining $50,365.83 was income of the attorneys, not of Mrs. Cotnam.

Id. at 126.[7]

The Fifth Circuit recently reaffirmed the holding of *Cotnam* in *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000). In *Srivastava*, the Fifth Circuit dispelled the notion that its decision in *Cotnam* turned upon the peculiarities of the attorney lien statute that applied to Mrs. Cotnam's fee agreement with her attorneys (that of Alabama): "Whatever are the attorney's rights against the defendant under Texas law as opposed to Alabama law, the discrepancy does not meaningfully affect the economic reality facing the taxpayer." *Id.* at 364. The Fifth Circuit expressly declined the Commissioner's invitation to overrule *Cotnam* and held that the attorney's fee portion of the taxpayer's award was not taxable as income to him. *Id.* at 365.

The Eleventh Circuit has similarly recently reaffirmed the holding of *Cotnam* in *Barlow-Davis v. Commissioner*, 210 F.3d 1346 (11th Cir. 2000). In *Barlow-Davis*, the Eleventh Circuit also declined the Commissioner of Internal Revenue's invitation to overrule *Cotnam*. *Id.* at 1347 n.4; see also *Foster v. United States*, 249 F.3d 1275, 1280-1281 (11th Cir. 2001) (awarding attorney's fees to taxpayer because Internal Revenue Service's position that attorney's fees constituted income to the successful plaintiff was "not substantially justified" in light of *Barlow-Davis* and *Cotnam*). Thus, a taxpayer residing in the Eleventh Circuit at the time she files her Tax Court petition, unlike a taxpayer, like Ms. Hukkanen,

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7 The Fifth Circuit has stated that "[t]he additional language offered by Judges Rives and Brown offers the best insight into the majority's reasoning." *Srivastava v. Commissioner*, 220 F.3d 353, 363 n.31 (5th Cir. 2000) (referring to the language quoted above).

residing in the Tenth Circuit, need not include fees received by her attorneys in her taxable income.[8]

The Sixth Circuit has also weighed in on the question of the tax treatment of contingent attorney's fees, and, like the Fifth and Eleventh Circuits, has rejected the Commissioner's argument that contingent attorney's fees paid by a defendant directly to a plaintiff's attorney constitute taxable income to the plaintiff. In *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000), the court was faced with the question of whether attorneys' fees attributable to the taxable interest component of a non-taxable award should be included in the successful plaintiff's income. Contrary to the Tenth Circuit's holding in this case, the Sixth Circuit held that the attorneys' fees portion was not income to the plaintiff-taxpayer. *Id.* at 857-858.

The Sixth Circuit held that a client who enters into a contingent fee arrangement with an attorney in order to pursue a claim has "lost his right to receive payment for the lawyer's portion of the judgment." 202 F.3d at 856. The court relied upon this effect of the contingent fee arrangement, combined with the speculative nature of the attorneys' engagement, in holding that the fees did not constitute income to the taxpayer, explaining:

> In the instant case, as in *Cotnam*, the value of taxpayer's lawsuit was entirely speculative and dependent on the services of counsel. The claim simply amounted to an intangible, contingent expectancy. The only economic benefit Clarks could derive from his claim against the

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8 The Tax Court has recognized the Eleventh Circuit's reaffirmation of *Barlow-Davis* and has applied its holding to cases appealable to that circuit under the *Golsen* doctrine (see *supra*, n.6) in *Griffin v. Commissioner*, T.C. Memo. 2001-5 (2001).

> defendant in state court was to use the contingent part of it to help him collect the remainder. Like an interest in a partnership agreement or joint venture, Clarks contracted for services and assigned his lawyer a one-third interest in the venture in order that he might have a chance to recover the remaining two-thirds. Just as in *Cotnam*, the assignment Clarks' lawyer received operated as a lien on a portion of the judgment sought to be recovered transferring ownership of that portion of the judgment to the attorney.

Estate of Clarks, 202 F.3d at 857. The court went on to explain why the execution of a contingent fee contract did not constitute an ineffective (for tax purposes) anticipatory assignment of income, stating that when the taxpayer engaged the attorneys, "there was no res, no fund, no proceeds, no vested interest, only a hope to receive money from the lawyer's efforts and the client's right, a right yet to be determined by judge and jury." *Ibid.*

All five of these decisions, *Cotnam*, *Srivastava*, *Barlow-Davis*, *Foster* and *Estate of Clarks*, from three different circuit courts of appeals, the Fifth, Sixth, and Eleventh Circuits, are directly contrary to the Tenth Circuit's holding in this case.

2. *Circuits, besides the Tenth Circuit, reaching the opposite conclusion of that of the Fifth, Sixth, and Eleventh Circuits*

The Tenth Circuit is not the first circuit to reach a conclusion at odds with the first decision addressing the tax treatment of contingent attorney's fees, the Fifth Circuit's decision in *Cotnam*. The Tenth Circuit cited decisions of four such circuits in its opinion. App., *infra*, 3a, citing *Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001); *Young v. Commissioner*, 240 F.3d 369 (4th Cir. 2001); *Coady v.*

Commissioner, 213 F.3d 1187 (9th Cir. 2000); and *Baylin v. United States*,[9] 43 F.3d 1451 (Fed. Cir. 1995).

With the exception of the Federal Circuit's opinion in *Baylin*, which failed to cite or acknowledge the contrary precedent of *Cotnam*, each of the cases cited by the Tenth Circuit acknowledged that there was a conflict among the circuits. See *Kenseth*, 259 F.3d at 883 ("The circuits are split on whether a contingent fee is, as the Tax Court held in this case, a part of the client's taxable income"); *Young*, 240 F.3d at 377-379 (explicitly rejecting *Cotnam* and *Estate of Clarks* and adopting the "majority" view); *Coady*, 213 F.3d at 1188-1190 (noting that "[t]he rule in *Cotnam* has been subject to disagreement among the circuit courts of appeals," and adopting approach of *Baylin*).

3. The split among the circuits is not attributable to differences in State law.

The Tenth Circuit opinion demonstrates some confusion about the role of State law in the Federal income tax determinations at issue in this case. On the one hand, the Tenth Circuit distinguished *Cotnam* and *Estate of Clarks* as cases in which a different State's law governed the scope of the attorney's lien created by a contingent attorney's fee contract. App., *infra*, at 3a. On the other hand, the court "agree[d] with Petitioner that a universal standard independent of the 'intricacies of any attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." *Id.* at 4a.

Despite the Tenth Circuit's apparent confusion, courts on both sides of the issue have nearly universally agreed that the

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9 The Tenth Circuit incorrectly lists the title of this case as *Baylin v. Maryland*. App., *infra*, 3a.

cases do not turn on State law. The Tenth Circuit itself quoted the relevant language from *Srivastava*, where the court declined to distinguish *Cotnam* on the basis of "the intricacies of an attorney's bundle of rights against the opposing party under the law of the governing state." App., *infra*, at 4a, quoting *Srivastava*, 220 F.3d at 364. After examining the *Cotnam* opinion and rationale, the Fifth Circuit in *Srivastava* declined the Commissioner's invitation to distinguish *Cotnam* on State law grounds, holding that distinctions regarding the scope of an attorney's power to enforce his rights "should not affect the analysis required by the anticipatory assignment of income doctrine, which looks to the taxpayer's degree of control and dominion over the asset." *Srivastava*, 220 F.3d at 363-364; see also *Estate of Clarks*, 202 F.3d at 857-858 (holding for taxpayer on this issue without relying on specific operation of State law).

Most courts reaching the same conclusion as the Tenth Circuit have been careful to explain that their decisions have not been based on differences in State law. For example, the Fourth Circuit, in holding against the taxpayer on the issue raised in this case, concluded that:

> As the Fifth Circuit itself has now recognized [in *Srivastava*], whether amounts paid directly to attorneys under a contingent fee agreement should be included within the client's gross income should be resolved by proper application of federal income tax law, not the amount of control state law grants to an attorney over the client's cause of action.

Young, 240 F.3d at 378-379; see also *Sinyard v. Commissioner*, 268 F.3d 756, 760 (9th Cir. 2001) (rejecting *Cotnam* and stating that "we do not see how the existence of a lien in favor of the taxpayer's creditor makes the satisfaction

of the debt any less income");[10] *cf. Kenseth*, 259 F.3d at 883-884 (relying solely on principles of Federal tax law in reaching conclusion).

The reason for courts' refusal to rely on State law in determining the Federal income tax consequences of contingent attorney's fee arrangements is plain. A State-by-State standard would require *every* circuit court of appeals to decide the tax effect of *every* State's law. See note 6, *supra*. The proper Federal income tax treatment of contingent attorney's fee arrangements requires interpretation and application of the Internal Revenue Code. The conflict among the circuits cannot be explained as being attributable to difference in State law.

B. Resolution of the Conflict among the Circuits Is Necessary to Promote Uniform Application of the Federal Income Tax Laws on an Important and Recurring Issue.

Under the current state of the law, as established by the decisions of the Tax Court and the various courts of appeals, the tax status of contingent attorney's fees depends upon the taxpayer's circuit of residence at the time she files a Tax Court petition. If the taxpayer lives in the Fifth, Sixth, or Eleventh Circuit, she does not recognize income on a defendant's payment made directly to her attorneys. The same taxpayer

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10 Prior to its decision in *Sinyard*, it appears that the Ninth Circuit employed a State-by-State approach that required a decision regarding the Federal income tax effect of each State's attorney lien law. See *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000) (relying on differences in California law); *Coady*, 213 F.3d at 1190 (relying on differences in Alaska law). The Ninth Circuit's statement in *Sinyard* indicates a departure from this previously-held view.

would recognize income if she lived elsewhere in the Nation on the petition filing date.[11/]

This situation is contrary to the principle that the Federal income tax laws should be applied uniformly, independent of geographic distinctions. The granting of Ms. Hukkanen's request for a writ of certiorari in this case would promote this desired uniformity. See, *e.g.*, *Turnbow v. Commissioner*, 368 U.S. 337, 339 (1961) (certiorari granted "on a matter of importance to the proper interpretation and uniform application of the Internal Revenue laws").

The issue upon which the circuits are split is a recurring and important question. Obviously, many individuals, like Ms. Hukkanen, retain attorneys on a contingent fee basis and successfully recover taxable damages from defendants. The inclusion of the attorney's fees portion of any recoveries under these agreements in the successful plaintiff's income often triggers alternative minimum tax liability, since any deduction for attorney's fees paid is likely to be large in relation to the taxpayer's income for the year of recovery. These results can be devastating. As Judge Beghe of the Tax Court has observed, "in cases in which the aggregate fees exceed 72-73 percent of the recovery, the [alternative minimum] tax can exceed the net recovery, resulting in an overall effective rate of tax that exceeds 100 percent of the net recovery." *Kenseth*, 114 T.C. at 421, 425-26 (Beghe, J., dissenting).

The circuit split has been widely recognized and the desirability of Supreme Court resolution of the issue has been

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11 In cases appealable to circuits that have not directly addressed the issue raised by this case, the Tax Court has declined to apply the analysis of the Fifth, Sixth, and Eleventh Circuits, holding that the attorney's fees are income to the attorney's client. See, *e.g.*, *Kenseth v. Commissioner*, 114 T.C. 399 (2000), *aff'd*, 259 F.3d 881 (7th Cir. 2001).

noted by many commentators. See, *e.g.*, Stephen D. Feldman, *Exclusion of Contingent Attorneys' Fees from Gross Income*, 68 U. CHI. L. REV. 1309, 1336 (2001) ("To resolve the circuit split and create a uniform doctrine, courts should permit exclusion of contingent attorneys' fees from a plaintiff's gross income in all cases"); Lauren E. Sheridan, *Trees in the Orchard or Fruit from the Trees?: The Case for Excluding Attorneys' Contingent Fees from the Client's Gross Income*, 36 GA. L. REV. 283, 287 (2001) ("There remains a deep split between the federal courts of appeal regarding the taxation of attorneys' contingent fees to clients"); Benjamin C. Rasmussen, *Taxation of an Attorney's Contingency Fee of a Punitive Damages Recovery: The* Srivastava *Approach*, 15 BYU J. PUB. L. 301, 301 (2001) ("Recently, a noticeable split has occurred in the federal circuit courts * * * . This dispute between the circuits seems ripe for determination by the United States Supreme Court").

The importance of the issue and the harsh effects of the result reached by the Tenth Circuit in this case have also received national media attention. See, *e.g.*, David Cay Johnston, *A "Stealth Tax" Is Creeping Up on Growing Numbers of Americans*, N.Y. TIMES, Feb. 17, 2002, Sec. 3, at 17; see also Doug Clark, *Hero Fought Off One Robber, Now Facing IRS*, SPOKANE SPOKESMAN-REVIEW, Apr. 29, 2001, at B1 (describing alternative minimum tax application to contingent attorneys fees and concluding that "[a]s crazy as it sounds, however, this AMT business all depends on your address"); Tom Herman, *Tax Report*, WALL ST. J., Aug. 2, 2000, at A1 (labeling the circuit split on this issue "a confusing jumble that the Supreme Court may have to untangle").

The resolution of the split among the circuits is crucial to the uniform application of the Federal tax laws in an important

area of tax law. This Court should grant the petition for a writ of certiorari to settle the issue.

II. THIS COURT SHOULD REVERSE THE TENTH CIRCUIT'S ERRONEOUS APPLICATION OF THE TESTS FOR INCOME RECOGNITION ESTABLISHED BY THIS COURT'S DECISIONS.

The Tenth Circuit's decision in this case is contrary to the tests for income recognition developed by this Court over the decades. Although the Tenth Circuit failed to even mention any of this Court's decisions defining the boundaries of "income," the court of appeals' rationale is contrary to those decisions. The Tenth Circuit summarily rejected Ms. Hukkanen's argument that she cannot be charged with income because she lacked the requisite dominion and control of the attorneys' fees portion of the lawsuit proceeds. App., *infra*, 3a. Because the Tenth Circuit's summary conclusion is contrary to this Court's decisions, this Court should grant the petition for a writ of certiorari and reverse that court's decision.

A. Under the Tests for Income Recognition Established by this Court's Opinions, the Attorneys' Fees Paid to Ms. Hukkanen's Attorneys Do Not Constitute Income to Her.

It is well-established that income cannot be attributed to a taxpayer who does not have a high degree of control over the source of the income. In retaining attorneys through a contingent fee arrangement, Ms. Hukkanen relinquished the control necessary to saddle her with the income tax burdens of the attorneys' fees portion of the proceeds. Her attorneys, by the contingent fee contract and the relevant attorney lien statute, obtained a property interest—a lien on the sexual harassment cause of action. Her attorneys had practical control over the cause of action, which had not ripened into a

valuable right prior to their intervention in the sexual harassment dispute. When the lawsuit defendant tendered a check made payable to the attorneys and Ms. Hukkanen, Ms. Hukkanen had no power to divest the attorneys of their portion of the payment. Accordingly, the attorneys' fees portion of the payment did not constitute income to Ms. Hukkanen.

1. Income cannot be attributed to a taxpayer who does not have control over the source of the income.

This Court has clearly established that unfettered control is the hallmark of income. In determining whether a taxpayer had transferred property or merely the right to receive income, it has explained:

> The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.

Commissioner v. Sunnen, 333 U.S. 591, 604 (1948). Similarly, the test has been summarized:

> The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Corliss v. Bowers, 281 U.S. 376, 378 (1930).

The control test has been used to identify situations where receipt of money does not give rise to income. For example, it is well-established that receipt of a loan does not give rise to income to the borrower because of the obligation to repay the funds. See *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983). However, an advance payment of the purchase price of goods constitutes income to the seller of the goods. In *Commissioner*

v. Indianapolis Power & Light Co., 493 U.S. 203, 208-209 (1990), this Court applied this economic "distinction * * * of degree rather than of kind" by applying a "complete dominion" test to determine whether a taxpayer recognized income. The Court observed that the issue "turns upon the nature of the rights and obligations" of the purported recipient of income. *Id.* at 209. If the funds received are not "'undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion,'" they do not constitute income to the recipient. *Ibid.* (quoting *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955)). The "key" to determining whether a taxpayer enjoys "complete dominion" is "whether the taxpayer has some guarantee that he will be allowed to keep the money." *Indianapolis Power & Light Co.*, 493 U.S. at 210.

As explained in the following section, Ms. Hukkanen did not have complete dominion and control over the portion of the lawsuit proceeds she pledged to her attorneys in the contingent fee agreement. She also was she the indefeasibly vested owner of her attorneys' portion of the award. Amounts over which she did not have complete control should not be included in her income.

2. Ms. Hukkanen did not have the control of the attorneys' fees portion of her lawsuit required to charge her with receipt of income.

Ms. Hukkanen entered into a contingent fee contract with the attorneys who represented her in the sexual harassment lawsuit and subsequent appeal. The contract provided that Ms. Hukkanen's attorneys would receive at least 45 percent of any recovery. Ex. 7-J. The contract also contained the following provision under the heading "Lien On the Claim":

> Attorneys will have a lien of [sic] the claim for the amounts stated above in the event of recovery, or, if no recovery is effected prior to his termination or withdrawal, the lien shall be for $150 per hour for all hours plus all unpaid expenses.

Id. The contractual lien on the cause of action was buttressed by Missouri law.[12]

Ms. Hukkanen's attorneys had a contractual and statutory lien on the attorneys' fees portion of the Title VII cause of action. At the time the defendant tendered a check for $150,000 payable to the attorneys and Ms. Hukkanen, the lien had already attached. Ms. Hukkanen had no legal right to divest her attorneys of their portion of the lawsuit proceeds. The attorneys' fees portion of the $150,000 check was never within Ms. Hukkanen's control. As set forth in the previous section, this absence of complete control mandates that Ms. Hukkanen not be attributed income on account of the payment to her attorneys. See *Corliss*, 281 U.S. at 378 ("income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income"). If anyone had "complete dominion" over the attorneys' fees

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12 The applicable Missouri statute provided that:

> The compensation of an attorney or counselor for his services is governed by agreement, express or implied, which is not restrained by law. From the commencement of an action or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action or counterclaim, which attaches to the verdict, report, decision or judgment in his client's favor, and the proceeds thereof in whosoever hands they may come; and cannot be affected by any settlement between the parties before or after judgment.

Mo. Ann. Stat. § 484.130 (West 1987).

portion of the proceeds, it was Ms. Hukkanen's attorneys, not her. See *Indianapolis Power & Light Co.*, 493 U.S. at 209-210.

This Court should grant a writ of certiorari and reverse the Tenth Circuit's misapplication of this Court's precedent. Ms. Hukkanen did not have the control of the attorneys' fees portion of her lawsuit necessary to include those fees in her income.

3. *The assignment of income doctrine is inapplicable to Ms. Hukkanen's retention of attorneys on a contingent fee basis.*

Nothing in the language of the Internal Revenue Code requires that the attorneys' fees portion of the lawsuit proceeds be attributed to Ms. Hukkanen. The only rationale under which the attorneys' fees could represent income to Ms. Hukkanen is the judicial "assignment of income" doctrine. The assignment of income doctrine originated in this Court and has evolved over the past 70 years. See *Helvering v. Eubank*, 311 U.S. 122 (1940); *Helvering v. Horst*, 311 U.S. 112 (1940); *Lucas v. Earl*, 281 U.S. 111 (1930). This Court has noted that the process of applying the assignment of income control test and "drawing the line" between legitimate transfers and assignments of income is "a recurrent difficulty." *Harrison v. Schaffner*, 312 U.S. 579, 583 (1941); see also *Jones v. Commissioner*, 306 F.2d 292, 296 (5th Cir. 1962) ("In seeking to reconcile the implications of the infinite variety of facts presented by the decided cases and all that has been said about the subject of anticipatory assignment of income, one is likely to be displeased with his own wits; and may find his mind teetering between conflicting conclusions").

Courts, regardless of their resolution of the issues, have frequently observed that the application of the assignment of income doctrine to attorneys' fees for alternative minimum tax

purposes produces harsh results. For example, the Tax Court in *Kenseth*, in an 8-5 split decision, held that attorneys' fees should be included in a plaintiff's income, despite acknowledging that "[c]ommentators and courts have long observed [the] potential for unfairness in the operation of the AMT in this [area]." *Kenseth*, 114 T.C. at 407 n.3. The Court of Appeals for the First Circuit has also noted that the application of the alternative minimum tax to individual taxpayers' deduction of legal expenses "smacks of injustice." *Alexander v. IRS*, 72 F.3d 938, 946 (1st Cir. 1995). There is no reason for this Court to perpetuate the injustice acknowledged by the Tax Court in *Kenseth* by applying the judicial assignment of income doctrine to Ms. Hukkanen in this case.

The assignment of income doctrine originated with Supreme Court cases involving intra-family transactions such as *Lucas v. Earl*, *Helvering v. Horst*, and *Sunnen*. In those cases, this Court thwarted taxpayer attempts to shift income within a family group. In *Lucas v. Earl*, the court applied the assignment of income doctrine to a situation in which a husband contracted to give his wife one-half of his future employment income. See 281 U.S. at 114-115. The taxpayer in *Helvering v. Horst* unsuccessfully attempted to shift income by detaching interest coupons from his bonds and giving them as a gift to his son. See 311 U.S. at 114. *Sunnen* involved a husband's transferring patent licensing contracts to his wife. See 333 U.S. at 595.

The assignment of income doctrine is particularly applicable to intra-family transfers because a taxpayer is presumed to retain dominion and control over income that remains within his family. Under such circumstances, the taxpayer is still able to enjoy the full benefit of the income. Stated differently, after an intra-family transfer, the transferor "retains sufficient power and control over the assigned

property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes." *Sunnen*, 333 U.S. at 604.

Another situation in which retention of control makes the assignment of income doctrine applicable is in assignments of personal services income. Even where a taxpayer assigns the income from his services to an unrelated party, courts tax the income to the person who performed the services and, therefore, earned the income. This treatment is grounded in the policy that the tax law should "tax salaries to those who earned them." *Earl*, 281 U.S. at 114. Thus, courts have not allowed taxpayers to avoid taxation by assigning personal services income. See, *e.g.*, *Eubank*, 311 U.S. at 124 (assigned insurance commissions payable for services rendered are income to transferor).

None of the traditional elements of an assignment of income case are present in Ms. Hukkanen's case. The contingent fee contract she entered into with her attorneys was an arm's-length transaction entered into for legitimate non-tax purposes. She did not perform any of the services from which the attorneys' fees arose, and she lacked the dominion and control over the attorneys' fees portion of the Title VII lawsuit necessary to trigger the inclusion of income. The assignment of income doctrine is therefore inapplicable and the Tenth Circuit's decision should be reversed.

Furthermore, the assignment of income doctrine is inapplicable to situations where the property right assigned is exceedingly contingent or speculative at the time of assignment. For example, in *Cold Metal Process Co. v. Commissioner*, 247 F.2d 864 (6th Cir. 1957), the court was faced with the tax consequences of Cold Metal's transfer of its interest in royalty payments that were being held pending a government cancellation suit seeking to invalidate the patents

at issue. The Sixth Circuit determined that Cold Metal did not recognize income upon the ultimate favorable resolution of the suit with the government and release of the royalties. It reasoned that the assignment of income doctrine did not apply because, at the time of the transfer, the claim for the royalties "was not income to Cold Metal"—"[i]t was an unliquidated chose in action." *Id.* at 872; see also *Jones v. Commissioner*, 306 F.2d 292, 301 (5th Cir. 1962) (where claim at the time of transfer was "uncertain, doubtful and contingent," the transferor had no income upon the subsequent recovery on the claim under the assignment of income doctrine).

The assignment of income doctrine is not applicable to the arm's-length transaction at issue in this case—Ms. Hukkanen's hiring of attorneys on a contingent fee basis. Ms. Hukkanen's claim was worthless without her attorneys' efforts. Even when those attorneys agreed to handle her case on a contingent fee basis, there was no guarantee that Ms. Hukkanen even had a valid claim. The assignment of income doctrine is not applicable to the assignment of speculative, inchoate rights, such as those possessed by Ms. Hukkanen at the time of the purported ineffective assignment. This Court should grant a writ of certiorari in order to correct the Tenth Circuit's (and other courts of appeals') misapplication of this Court's income recognition and assignment of income precedents.

B. The Tenth Circuit's Decision Leads to Absurd Results at Odds with the Legislative Purposes of the Alternative Minimum Tax and Title VII.

In this case, the language used in the statute at issue ("income" in 26 U.S.C. § 61(a)) is far from clear. But, even in situations where the plain language used in a statute *is* clear, it is well-established that a statute should not be construed to produce absurd results. See *United States v. Brown*, 333 U.S.

18, 27 (1948) ("No rule of construction necessitates our acceptance of an interpretation resulting in patently absurd consequences"). The Tenth Circuit's interpretation of section 61 and the alternative minimum tax provisions and application of the judicial assignment of income doctrine leads to absurd results both in this case and when applied to other plaintiff-taxpayers.[13/] These absurd results contravene the legislative purposes of both the alternative minimum tax and Title VII.

The Tax Court and the Tenth Circuit in this case held that the portion of the proceeds paid directly to Ms. Hukkanen's attorneys was taxable to her for purposes of computing her alternative minimum tax liability. If those decisions stand, the $150,000 payment made by the sexual harassment lawsuit defendant will be divided up as follows:

$150,000	Total Payment
-$73,399	Attorneys' Fees
-$20,075	Regular Tax Paid with Return
-$17,402	Additional Tax Attributable to AMT
$39,124	Amount Ms. Hukkanen Received

Under the Tenth Circuit's holding, Ms. Hukkanen will net 26 percent (before considering the substantial accrued interest on the additional tax liability) of the $150,000 payment instead of the 38 percent she would have netted in the absence of the imposition of the asserted alternative minimum tax deficiency. The result of the Tenth Circuit's statutory interpretation is absurd.

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13 This is not a case in which applying a statute written by Congress produces such a result. As explained above, the assignment of income doctrine is a court-fashioned rule. Accordingly, it is clearly within the Court's purview to temper its application to avoid unjust, illogical results.

Even more absurd, however, are the results of the Tenth Circuit's holding when applied to plaintiff-taxpayers whose attorneys retain larger percentage contingent fees. As Judge Beghe noted in his dissent in *Kenseth*, "in cases in which the aggregate fees exceed 72-73 percent of the recovery, the tax can exceed the net recovery, resulting in an overall effective rate of tax that exceeds 100 percent of the net recovery." *Kenseth*, 114 T.C. at 421, 425-426 (Beghe, J., dissenting).

Regardless of the exact calculation, it is certainly possible that plaintiffs could receive a net recovery of less than zero under the Tenth Circuit's methodology. This danger is especially high in discrimination lawsuits, where actual damages may be low but the societal interest in the outcome and corresponding attorneys' fees are high.

The Tenth Circuit's holding in this case is contrary to the legislative purpose of the alternative minimum tax. The current version of the individual alternative minimum tax was enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. The Senate Finance Committee Report for that act explained the purpose of the revised alternative minimum tax:

> The committee has amended the present minimum tax provisions applying to individuals with one overriding objective: no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions and credits. * * * The ability of high-income individuals to pay little or no tax undermines respect for the entire tax system and, thus, for the incentive provisions themselves.

S. REP. NO. 97-494, VOL. 1, at 108 (1982). These purposes were reiterated by Congress when it amended the alternative

minimum tax with the Tax Reform Act of 1986, Pub. L. No. 99-514. See S. REP. NO. 99-313, at 520 (1986).

Ms. Hukkanen is not a "high-income individual" attempting to "avoid" taxation on "substantial economic income" by excluding the payment to her attorneys from her income. First, the payment directly to her attorneys, over which she had no control, did not enhance her financial condition at all. She received no economic income from the payment to her attorneys. Second, Ms. Hukkanen has hardly "avoided" taxation by paying an effective tax rate of 26 percent on the net proceeds of the award, rather than the 49 percent effective rate imposed under the Tax Court's holding.

Ms. Hukkanen paid regular income tax on the amount that was paid to her—her true "economic income." The Tenth Circuit's holding results in her being taxed on the payment by the defendant to her attorneys. This absurd result conflicts with the legislative purpose of the alternative minimum tax and should be reversed.

The Tenth Circuit's decision also undermines the legislative purposes behind Title VII. Title VII of the Civil Rights Act of 1964 was enacted to combat discrimination in employment. See *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 348 (1977). Title VII contains a "fee-shifting" provision, 42 U.S.C. § 2000e-5(k), that was intended to encourage potential plaintiffs to bring meritorious suits.[14/] A Title VII plaintiff such as Ms. Hukkanen acts not just for herself, but also as a "private attorney general," vindicating national policy. See *Newman v. Piggie Park Enters.*, 390 U.S. 400, 402 (1968); see also *Christiansburg Garment Co. v.*

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14 In Ms. Hukkanen's case, the district court awarded $85,227 in attorney's fees under 42 U.S.C.A. § 2000e-5(k). Ex. 6-J at 2. This amount was reduced on appeal. Ex. 8-J.

EEOC, 434 U.S. 412, 418 (1978) (the Title VII plaintiff is the "chosen instrument of Congress to vindicate 'a policy that Congress considered of the highest priority'" (citing *Piggie Park*)). Ms. Hukkanen should not be penalized for assuming this role.

The Tenth Circuit's decision in this case undermines the purpose of Title VII generally and the purpose of the fee-shifting provision of Title VII specifically.[15] By treating plaintiff-taxpayers as receiving income from payments to their attorneys, the Tenth Circuit's holding discourages plaintiffs with meritorious discrimination claims from bringing suit, even when the possibility of an award of attorneys' fees is taken into account. An award of attorneys' fees results in additional tax liabilities for successful plaintiffs under the Tenth Circuit's holding in this case. These additional tax liabilities can easily make meritorious suits economically infeasible to pursue.

In addition to its other errors, the Tenth Circuit's decision leads to absurd results inconsistent with the purpose of the alternative minimum tax and undermines Title VII.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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15 Commentators agree. See, *e.g.*, Laura Sager & Stephen Cohen, *How the Income Tax Undermines Civil Rights Law*, 73 S. CAL. L. REV. 1075 (2000).

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UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 00-9030

NANCY J. HUKKANEN-CAMPBELL,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from the Decision of the
United States Tax Court
(T.C. Docket No. 12371-98)

[Filed December 19, 2001]

Before KELLY and McKAY, Circuit Judges, and BROWN, Senior District Judge.*

McKAY, Circuit Judge.

Petitioner prevailed in a Title VII lawsuit against her former employer. The defendant in that action paid Petitioner $150,000 in partial satisfaction of the judgment. The $150,000 payment was issued jointly to Petitioner and her attorneys. She received $76,600.75 of the settlement; her attorneys retained the remaining $73,399.25 as legal fees.

* Honorable Wesley E. Brown, Senior United States District Judge for the District of Kansas, sitting by designation.

Originally, Petitioner reported the entire $150,000 as "Other Income" on her 1993 federal income tax return. She also claimed an itemized deduction for the legal fees. In 1995, she filed an amended tax return in which she excluded the $150,000 payment from her income entirely, claiming a refund of $20,075. The Commissioner denied the refund and issued to her a deficiency notice in the amount of $17,402. This deficiency resulted from the application of the Alternative Minimum Tax ("AMT"). The AMT precludes various miscellaneous itemized deductions including fees paid to attorneys by taxpayers.

Petitioner challenged the deficiency in Tax Court arguing that the proceeds of the lawsuit were excluded from income under § 104(a)(2). Alternatively, she argued that the portion paid to her attorneys pursuant to her contingent fee arrangement was not includable in gross income. The Tax Court held that the entire $150,000 was subject to taxation and that the amount paid to her attorneys qualified as a miscellaneous itemized deduction. However, since the computation of the AMT disallows deductions for attorney fees, the Tax Court upheld the $17,402 deficiency. Petitioner timely appealed. We have jurisdiction under 26 U.S.C. § 7482(a)(1).

The current dispute has increased meaning because of the AMT's treatment of attorney fees. If the AMT did not apply, any fees Petitioner paid to her attorneys would qualify as a deductible expense. However, under the AMT's provisions, certain miscellaneous deductions, including attorney fees, are eliminated.

Petitioner argues that the Internal Revenue Code does not require that the payment made to her attorneys be included in her income. Section 61(a) of the Code defines gross income as "all income from whatever source derived." 26 U.S.C. § 61(a). The $150,000 she recovered in her Title VII suit clearly constitutes income from "whatever source derived."

We reject Petitioner's argument that she lacked the requisite control and beneficial ownership of the funds paid directly to her attorney. Regardless of the label placed on the contract between Petitioner and her attorneys, the end result is that the recovery of legal fees benefitted her. This recovery permitted Petitioner to discharge the personal obligation owed to her attorneys. *See Coady v. Commissioner*, 213 F.3d 1187, 1191 (9th Cir. 2000); *Baylin v. United States*, 43 F.3d 1451, 1454 (Fed. Cir. 1995).

Petitioner's argument that the effect of her contingent fee agreement and the Missouri lien statute alters the analysis is equally unavailing. Petitioner points to rulings in other circuits holding that contingent fees paid directly to attorneys are not taxable income based on the applicable attorney lien statutes. *See, e.g., Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001) (Alabama statute); *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000) (Michigan statute); *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959) (Alabama statute). However, the majority of the circuits have rejected this argument. *See, e.g., Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001) (Wisconsin statute); *Young v. Commissioner*, 240 F.3d 369 (4th Cir. 2001) (North Carolina statute); *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000) (California statute); *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000) (Alaska statute); *Baylin v. Maryland*, 43 F.3d 1451 (Fed. Cir. 1995) (Maryland statute).

Furthermore, the cases Petitioner relies upon are readily distinguished. As the Tax Court correctly noted, the Missouri lien statute, unlike the Alabama and Michigan statutes, does not create a proprietary interest in the recovery on the attorney's behalf. Instead, the Missouri statute simply operates as a manner of ensuring payment to the attorney. As the Seventh Circuit recently observed, an attorney with a lien on settlement "is no different in this respect from any other trade creditor stiffed by his debtor." *Kenseth*, 259 F.3d at 884.

Petitioner urges us to adopt a uniform standard that contingent fee payments made directly to attorneys for their services should not be taxable to successful plaintiffs. She advocates a standard independent of "the intricacies of an attorney's bundle of rights against the opposing party under the law of the governing state." Aplt. Brief at 25 (quoting *Srivastava v. Commissioner*, 220 F.3d 353, 364 (5th Cir. 2000). Her reliance on *Srivastava* is misplaced. In *Srivastava*, the Fifth Circuit specifically stated, "[W]ere we to decide this case as an original matter, we might apply the anticipatory assignment doctrine to hold that contingent fees are gross income to the client. We do not, however, decide this case on a clean slate, but must follow the contrary approach endorsed in *Cotnam*." *Srivastava*, 220 F.3d at 363. Not only has the Fifth Circuit's ruling in *Srivastava* been widely criticized, *see, e.g.*, Benjamin C. Rasmussen, Note, *Taxation of an Attorney's Contingency Fee of a Punitive Damages Recovery: The Srivastava Approach*, 15 BYU J. Pub. L. 301 (2001), but we, unlike the Fifth Circuit, decide this case on a clean slate.

We agree with Petitioner that a universal standard independent of the "intricacies of any attorney's bundle of rights," or the unique provisions of a particular state's attorney lien statute is desirable. However, her proposed solution is inconsistent with the Tax Code. The correct approach is much more simple. Petitioner's judgment is a recovery of lost income; the attorney fees she paid represent expenses incurred in generating that income. Like any other taxpayer, Petitioner must report the entire amount as gross income, and, but for the AMT's provisions, she would be allowed to deduct her attorney fees as an expense. The Tax Code mandates this result irrespective of a particular state's attorney lien statute's provisions.

Finally, Petitioner invites us to judicially overturn what she terms an "anomalous and unjust result" created by the application of the AMT to the present case. We must reject this invitation. The perceived inequities of the AMT are simply

not at issue here. Congress, not this court, must correct any shortcomings in the AMT's application.

The Tax Court's decision is **AFFIRMED**.

UNITED STATES TAX COURT

Docket No. 12371-98

NANCY J. HUKKANEN-CAMPBELL,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Filed June 12, 2000.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, *Judge*: In a notice of deficiency addressed to petitioner, respondent determined a deficiency of $17,402 in petitioner's Federal income tax for the year ended December 31, 1993. The issues for our consideration are: (1) Whether petitioner's $150,000 judgment received in an action under the pre-1991 title VII of the Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241 (title VII), is excludable from gross income under section 104(a)(2); and (2) if the title VII proceeds are includable in income, whether petitioner is entitled to exclude from gross income that portion of the proceeds paid as attorney's fees under her contingent fee retainer agreement.

FINDINGS OF FACT[1]

The facts in this case have been fully stipulated, and the case was submitted to the Court under Rule 122.[2] Petitioner resided in Shawnee, Kansas, at the time her petition was filed in this case.

Petitioner was employed at the International Union of Operating Engineers, Hoisting and Portable Local No. 101 (Local 101) from July 10, 1978, to October 29, 1984. On May 23, 1990, petitioner filed a Complaint in the U.S. District Court for the Western District of Missouri, Western Division, against Local 101 and against Sam F. Long (Long), the Chief Executive Officer of Local 101 during petitioner's employment. Petitioner's Complaint contained the allegation that, in 1984, she was constructively discharged in violation of title VII. Petitioner sought injunctive relief, backpay, front pay (the monetary equivalent of reinstatement), benefits, attorney's fees, and reasonable costs.

The District Court ruled in favor of petitioner and found that petitioner had been subjected to unwelcome sexual harassment based on petitioner's gender and that such harassment was sufficiently severe and pervasive so as to unreasonably interfere with her work performance and create an intimidating, hostile, and offensive work environment. The District Court entered a Final Judgment on April 3, 1992, awarding petitioner $52,492 in backpay, $44,418.06 in front pay, $82,534.81 in pension benefits, $85,227.50 in attorney's fees, and $1,016.90 in reasonable costs. Local 301 and Long appealed, and petitioner cross-appealed, to the U.S. Court of Appeals for the Eighth Circuit. The Court of Appeals upheld the backpay, front pay,

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[1] The stipulation of facts and the attached exhibits are incorporated herein by this reference.

[2] Unless otherwise indicated, Rule references are to this Court's Rules of Practice and Procedure, and section references are to the Internal Revenue Code in effect for the taxable year in question.

and pension benefits, and remanded the attorney's fees award to the District Court for further consideration. See *Hukkanen v. International Union of Operating Engrs., Hoisting & Portable Local No. 101*, 3 F.3d 281 (8th Cir. 1993).

In connection with petitioner's lawsuit, petitioner and her attorneys entered into a Contract for Employment for Litigation on a Contingency Fee Basis (contingency fee contract). The contingency fee contract provided that petitioner's attorneys would receive 45 percent of the total recovery, including attorney's fees, or $125 per hour for all time from the beginning of the case to completion, or the court-awarded fee, whichever figure was greater, plus any expenses that were not paid by petitioner. In no event, however, was petitioner to receive less than 25 percent of the combined award of attorney's fees and client award after deduction of expenses.

On December 21, 1993, Local 101 paid petitioner $150,000 in partial satisfaction of the title VII judgment. The payment was made jointly to petitioner and her attorneys. Ultimately, $76,600.75 was retained by petitioner, and $73,399.25, as legal fees, was retained by petitioner's attorneys.

Petitioner timely filed her Federal income tax return for the 1993 taxable year (1993 original return) and reported the entire $150,000 judgment as "Other income" and reported the $73,399.25 in attorney's fees as a miscellaneous itemized deduction. In 1995, petitioner filed an Amended U.S. Individual Income Tax Return, Form 1040X, for the 1993 taxable year, excluding the $150,000 judgment from income, thereby eliminating the need to claim the $73,399.25 in attorney's fees. As a result, petitioner reported that her corrected tax liability was $437, that she had paid $20,512, and that she was entitled to a refund of $20,075.

OPINION

Respondent determined that petitioner's 1993 gross income included the $150,000 award. Respondent also determined that

petitioner's legal fees and costs totaling $73,399.25 were deductible as a miscellaneous itemized deduction, subject to the 2-percent floor under section 67. Respondent did not allow the miscellaneous itemized deduction for legal fees in computing petitioner's alternative minimum taxable income. Thus, under respondent's determination, petitioner would be subject to alternative minimum tax (AMT), under sections 55 and 56, of $17,402. Petitioner contends that the $150,000 award is excludable from income, or alternatively, if the award is not excludable, the portion of the award paid as attorney's fees is excludable from income, and petitioner is not liable for AMT.

Excludability of Title VII Judgment Proceeds

We must first decide whether petitioner's title VII judgment proceeds are excludable from gross income. Except as otherwise provided, gross income includes income from all sources. See sec. 61(a); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Although section 61(a), concerning the inclusion of income, has been broadly construed, statutory exclusions from income have been more narrowly construed. See *Commissioner v. Schleier*, 515 U.S. 323, 327-328 (1995); *Kovacs v. Commissioner*, 100 T.C. 124, 128 (1993), affd. without published opinion 25 F.3d 1048 (6th Cir. 1994).

One such statutory exclusion appears in section 104(a)(2). Under section 104(a)(2), gross income does not include "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness". The regulations provide that

> The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, through a settlement agreement entered into in lieu of such prosecution.

Sec. 1.104-1(c), Income Tax Regs. Thus, damages may be excluded from gross income only if petitioner shows that (1) the underlying cause of action giving rise to the recovery is based upon tort or tort type rights, and (2) the damages were received on account of personal injuries or sickness. See *Commissioner v. Schleier*, *supra* at 336-337; *Wesson v. United States*, 48 F.3d 894, 901-902 (5th Cir. 1995); *Bagley v. Commissioner*, 105 T.C. 396, 416 (1995), affd. 121 F.3d 393 (8th Cir. 1997).

When damages are received pursuant to a suit or settlement agreement, the nature of the underlying claim determines whether such damages are excludable under section 104(a)(2). See *United States v. Burke*, 504 U.S. 229 (1992); *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989), affg. 89 T.C. 632 (1987); *Robinson v. Commissioner*, 102 T.C. 116, 126 (1994), affd. in part, revd. in part, and remanded on another ground 70 F.3d 34 (5th Cir. 1995). Determining the nature of the claim is a factual inquiry. See *Bagley v. Commissioner*, *supra* at 406; *Stocks v. Commissioner*, 98 T.C. 1, 11 (1992). The claim must be bona fide, but not necessarily valid. See *Taggi v. United States*, 35 F.3d 93, 96 (2d Cir. 1994); *Robinson v. Commissioner*, *supra* at 126; *Stocks v. Commissioner*, *supra* at 10. The crucial question is "in lieu of what was the settlement amount paid?" *Bagley v. Commissioner*, *supra* at 406.

In *United States v. Burke*, *supra*, the taxpayers brought a sex discrimination claim under title VII against their employer. The parties subsequently settled the case, and the employer withheld Federal income taxes on the settlement received by the taxpayers. The taxpayers sought refunds of the withheld taxes on the ground that the settlement was excludable under section 104(a)(2) as "'damages received * * * on account of personal injuries or sickness.'" *Id.* at 232 (quoting section 104(a)(2)).

The Supreme Court held that the nature of the claim underlying the taxpayers' settlement determined the

excludability of the settlement under section 104(a)(2). See *id.* at 237. The Court noted that title VII focused on "'legal injuries of an economic character'" and limited the available remedy to backpay awards and injunctive relief. *Id.* at 238-239 (quoting *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975)). The Court further stated:

> Nothing in this remedial scheme purports to recompense a Title VII plaintiff for any of the other traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, or other consequential damages * * *.

Id. at 239. Because the taxpayers' remedies under title VII were limited to wages on which they otherwise would have been taxed, the Court held that title VII's sole remedial focus was the award of back wages and did not redress a tortlike personal injury within the meaning of section 104(a)(2) and the applicable regulations. See *id.* at 241. As such, the settlements received by the taxpayers pursuant to their title VII claims were not excludable from gross income under section 104(a)(2).

Similar to the taxpayers in *United States v. Burke*, *supra*, petitioner brought a claim under title VII against her employer. Since the damages available to petitioner as a title VII claimant consisted only of wages,[3] which would otherwise be taxable, the $150,000 recovery received by petitioner as partial payment

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[3] In 1991, the Civil Rights Act, Pub. L. 102-166, 105 Stat. 1071 (1991), expanded the damages available under title VII and created a right of recovery for compensatory and punitive damages for certain intentional violations of title VII. In *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994), the Supreme Court held that the 1991 amendments to the Civil Rights Act did not apply retroactively. Because petitioner's title VII suit was filed in 1990 and the conduct underlying the suit occurred from 1981 to 1984, the application of sec. 104(a)(2) to any amounts received from petitioner's title VII claim must be considered in light of the Civil Rights Act as it existed prior to the 1991 amendments. See *Clark v. Commissioner*, T.C. Memo. 1997-156. In any event, there is no evidence that petitioner sought in her Complaint or was awarded damages on account of personal injury.

of her title VII judgment does not constitute "damages received * * * on account of personal injuries". Thus, under the reasoning of *Burke*, petitioner's title VII recovery is not excludable from gross income under section 104(a)(2).

Petitioner advances several arguments in support of her contention that the proceeds received from her title VII claim are excludable from income. Petitioner's first argument draws upon the reasoning contained in a dissenting view expressed by Justice O'Connor in *United State v. Burke*, *supra* at 249. That dissenting view suggests that the focus should be on the broad policy underlying title VII rather than the possible remedies available to claimants. In the dissent, it was also pointed out that title VII actions did not "fix the character of the right" that plaintiffs were seeking to enforce. Trying to capitalize on that reasoning, petitioner contends that, under the laws of her State, her suit was based in common-law torts (assault, battery, sexual assault, and sexual battery). Although the form of the title VII relief was denominated as "wages", petitioner argues that, in substance, her claim was founded in tort. We note, however, that if petitioner had an alternative cause of action under State law, she chose not to pursue it and, instead, brought her action under title VII.

In order to bolster her substance argument, petitioner cites *Central Foundry Co. v. Commissioner*, 49 T.C. 234, 251 (1967), and states that the tax treatment of the result of litigation should not turn upon which remedy or course of action is selected by the taxpayer. *Central Foundry Co.* addressed whether a corporation could deduct the reimbursement of shareholders' expenses from a successful proxy fight as ordinary and necessary business expenses. The Court stated that no matter which remedy the shareholder selected, a derivative action or a proxy contest, it was the proximate relationship to the corporation and the benefit to the corporation that determined whether the expenses were deductible. *Central Foundry Co.*, however, has not been relied upon by this Court, or any other court, for guidance in

determining whether recoveries by taxpayers are excludable from gross income under section 104(a)(2). Thus, we do not view *Central Foundry Co.* as persuasive support for petitioner's position that the focus should be on the legislative policy underlying title VII rather than the possible remedies available to claimants.

More important, however, is the fact that the Supreme Court did not follow the dissent's view in *Burke* and held that a claim under title VII is not based on a "tort or tort type" right, taking account of the kinds of remedies that may be awarded for that claim. *United States v. Burke*, *supra* at 234-237. Because pre-1991 title VII remedies were limited to backpay and injunctive relief, the Court held that a sex discrimination claim did not assert a "tort or tort type" right. Regardless of whether petitioner's claims may have had an analogue at common law, the Supreme Court in *Burke* looked to the remedy that was addressed by title VII.

Petitioner also argues that *Burke* should be read narrowly to apply to cases based on economic acts that result predominately in economic harm. Petitioner contends that in cases where common law tort remedies exist, *Burke* should not apply. Petitioner, in an attempt to distinguish *Burke*, points out that the taxpayers' sole claim in that case was for damages based on economic rights, whereas petitioner had a tort claim at common law. We disagree with petitioner since the majority opinion in *Burke* did not address possibilities outside of title VII.

More importantly, petitioner's recovery here was based entirely on title VII, and no evidence was presented establishing that petitioner had any other remedies at common law. Even assuming petitioner did have other avenues of relief outside title VII, petitioner chose to file a title VII action and is now bound by the tax consequences that attach to recoveries under title VII. We hold that the proceeds from petitioner's title VII award are not excluded from gross income under section 104(a)(2).

Excludability of Attorney's Fees

The next issue for our consideration is whether petitioner is entitled to exclude from her gross income that portion of her title VII proceeds paid as attorney's fees. Petitioner argues that if section 104(a)(2) does not apply and her title VII judgment proceeds are includable in her 1993 gross income, the $73,399.25 paid to her attorneys is excludable from her gross income because it was paid directly to her counsel under a contingent fee retainer agreement. We note at the outset that this Court has, relying on the well-established assignment of income doctrine, uniformly rejected the contention that taxpayers may exclude the amount of their legal fees and costs from gross income. See *Kenseth v. Commissioner*, 114 T.C. ____ (2000); *O'Brien v. Commissioner*, 38 T.C. 707, 712 (1962), affd. per curiam 319 F.2d 532 (3d Cir. 1963); *Benci-Woodward v. Commissioner*, T.C. Memo. 1998-395.

Petitioner relies on *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), affg. in part and revg. in part 28 T.C. 947 (1957), arguing that, under the "attorney's lien" rationale, an attorney's contingent fee portion of a judgment is not included in the taxpayer's income. In *Cotnam*, the taxpayer and her attorneys entered into a contingent fee agreement under which the attorneys would receive 40 percent of any amount recovered on behalf of the taxpayer on her claim. The taxpayer received a judgment on the claim, and a check in the amount of the judgment was made payable to both her and her attorneys. The attorneys retained their share of the proceeds and remitted the rest to the taxpayer. In holding that the amount retained by the attorneys was not includable in the taxpayer's gross income, the Court of Appeals for the Fifth Circuit concluded that under Alabama State law (the applicable law in *Cotnam*) the contingent fee arrangement operated to assign to the attorneys an equitable lien and interest as to 40 percent of the judgment. As stated in the provision of the Alabama Code relied upon by the Court of Appeals:

> 2. Upon suits, judgments, and decrees for money, * * * [attorneys] shall have a lien superior to all liens but tax liens, and no person shall be at liberty to satisfy said suit, judgment or decree, until the lien or claim of the attorney for his fees is fully satisfied; and attorneys at law shall have the same right and power over said suits, judgments and decrees, to enforce their liens, as their clients had or may have for the amount due thereon to them.

Cotnam v. Commissioner, *supra*, at 125 n.5 (quoting 46 Ala. Code sec. 64 (1940)).

The parties here agree that Missouri law is the applicable law in this case. Petitioner argues that the Missouri statute regarding attorney liens is similar to that of the Alabama statute quoted above, and therefore *Cotnam* is applicable here. We disagree. In the present case, the applicable Missouri statute provides as follows:

> The compensation of an attorney or counselor for his services is governed by agreement, express or implied, which is not restrained by law. From the commencement of an action or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action or counterclaim, which attaches to a verdict, report, decision or judgment in his client's favor, and the proceeds thereof in whosesoever hands they may come; and cannot be affected by any settlement between the parties before or after judgment.

Mo. Ann. Stat. sec. 484.130 (West 1987). This provision stands in marked contrast to the provision of the Alabama Code relied on in *Cotnam*. Although both provisions give an attorney a lien to secure his or her compensation, the Missouri provision, unlike the Alabama provision, does not give attorneys the same right and power over suits, judgments, and decrees as their clients had or may have.

While we agree with petitioner that Missouri law does provide attorneys with a lien interest in their client's cause of action, we are unable to find, and petitioner fails to cite, any authority under Missouri law that transfers to the attorneys an ownership or proprietary interest in their client's cause of action. Rather, the cases that petitioner has cited only allow attorneys a lien interest, as opposed to an equity or ownership interest, in their client's cause of action. In Missouri, attorneys do not have the same substantive rights in proceeds recovered on behalf of their clients as do attorneys in Alabama. See *Mills v. Metropolitan St. Ry. Co.*, 221 S.W. 1, 4 (Mo. 1920) ("the cause of action is the property of the client and not the attorney").

The Missouri provision granting a lien interest to secure an attorney's compensation is more akin to those attorney lien provisions of States that have been distinguished from the attorney lien provisions of Alabama. See *Baylin v. Commissioner*, 43 F.3d 1451, 1455 (Fed. Cir. 1995) (holding Maryland attorney lien statute does not give attorney an ownership interest in claim of his or her client); *Estate of Gadlow v. Commissioner*, 50 T.C. 975, 979-980 (1968) (Pennsylvania law distinguishable from Alabama statute); *Petersen v. Commissioner*, 38 T.C. 137, 151-152 (1962) (holding Nebraska attorney lien statute distinguishable from Alabama attorney lien statute); *Coady v. Commissioner*, T.C. Memo. 1998-291 (Alaska attorney lien statute distinguishable from Alabama statute).

Petitioner next contends that Missouri law provides the same attorney lien priority as does Alabama law. In *Cotnam*, the court interpreted Alabama law as providing an attorney lien with a superior priority over the defendant's set-off right against the plaintiff. See *Cotnam v. Commissioner*, *supra* at 125. Petitioner relies on *Hillside Enters., Inc. v. Carlisle Corp.*, 944 F. Supp. 793, 802 (E.D. Mo. 1996), for the proposition that Missouri case law has recognized the same superior attorney lien priority concept as stated in *Cotnam*. The District Court's

decision in *Hillside*, however, was reversed by the Court of Appeals for the Eighth Circuit in *Hillside Enters. Inc. v. Continental Carlisle, Inc.*, 147 F.3d 732 (8th Cir. 1998). In reversing, the Court of Appeals concluded that the lower court's holding regarding the attorney lien priority was contrary to Missouri law and that, under Missouri law, an attorney's lien on the plaintiff's judgment is inferior to the defendant's right to set off its own judgment against the plaintiff. *Hillside Enters., Inc. v. Continental Carlisle, Inc.*, 147 F.3d at 735. The fact that Missouri law subordinates an attorney's lien to the rights existing between the parties to the action or proceeding clearly distinguishes it from the Alabama provision cited in *Cotnam* where the lien of an attorney is "superior to all liens but tax liens." 46 Ala. Code sec. 64 (1940). Based on the foregoing, we find petitioner's case distinguishable from *Cotnam* and hold that petitioner's gross income includes the $73,399.25 of her title VII proceeds paid to her counsel as attorney's fees.[4]

Petitioner complains that she is not subject to AMT because the attorney's fees portion of the judgment is not included in gross income. We have held that petitioner's gross income includes the portion of her title VII proceeds paid to her counsel as attorney's fees, and therefore petitioner's argument that she is not subject to AMT is rejected.

Petitioner concedes that if the entire $150,000 award is included in her gross income, the proper treatment of the attorney's fees is as a miscellaneous itemized deduction as reported on petitioner's 1993 original return. Section 162 (a) provides that there "shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". Legal fees incurred by a taxpayer as an expense of employment are

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[4] We would reach this same holding irrespective of the differences between the Missouri and Alabama attorney lien statutes. See *Kenseth v. Commissioner*, 114 T.C. ___ (2000) (majority rejected the reasoning of *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), affg. in part and revg. in part 28 T.C. 947 (1957)).

miscellaneous itemized deductions, subject to the overall limitation on itemized deductions. See secs. 67 and 68; *Alexander v. Commissioner*, 72 F.3d 938 (1st Cir. 1995); affg. T.C. Memo. 1995-51; *Bagley v. Commissioner*, 105 T.C. at 419. Accordingly, petitioner's legal fees are deductible as a miscellaneous itemized deduction.

Petitioner does not dispute respondent's contention that the treatment of the attorney's fees as a miscellaneous itemized deduction triggers the application of the AMT under sections 55 and 56. Under section 56(b)(1)(A)(i), an individual taxpayer's deduction for miscellaneous itemized deductions is not allowed in computing alternative minimum taxable income. See *Alexander v. Commissioner*, *supra* at 946-947. Therefore, petitioner is not permitted to deduct her attorney's fees as a miscellaneous itemized deduction for purposes of computing AMT.

To reflect the foregoing,

Decision will be entered for respondent.

Supreme Court, U.S.
FILED
APR 10 2002
OFFICE OF THE CLERK

(2)

No. 01-1348

In the Supreme Court of the United States

NANCY J. HUKKANEN-CAMPBELL, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner may exclude from her gross income the portion of an award of damages that was retained by her attorney pursuant to a contingent fee agreement.

In the Supreme Court of the United States

No. 01-1348

NANCY J. HUKKANEN-CAMPBELL, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-5a) is reported at 274 F.3d 1312. The opinion of the Tax Court (Pet. App. 6a-18a) is reported at 79 T.C.M. (CCH) 2122.

JURISDICTION

The judgment of the court of appeals was entered on December 19, 2001. The petition for certiorari was filed on March 11, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner filed a lawsuit against her former employer in the United States District Court for the

Western District of Missouri, alleging that she had been constructively discharged from her employment in violation of Title VII. Petitioner sought injunctive relief, back pay, front pay, benefits, attorney's fees and costs. Pet. App. 7a. In connection with that suit, petitioner entered into a contingent fee agreement with her attorneys. That agreement provided that the attorneys would receive all expenses incurrred in connection with the litigation and 45 percent of the total recovery (including any award of attorney's fees), or $125 per hour for all time from the beginning of the case to completion, or the court-awarded fee, whichever figure was greater. In no event, however, was petitioner to receive less than 25 percent of the combined award of damages and attorney's fees, after expenses. *Id.* at 8a.

On April 3, 1992, the district court entered a final judgment awarding petitioner $52,492 in back pay, $44,418 in front pay, $82,534 in pension benefits, $85,227 in attorney's fees, and $1016 in costs. The court of appeals upheld the awards of back pay, front pay and pension benefits, and remanded the attorney's fees award to the district court for further consideration. *Hukkanen* v. *International Union of Operating Eng'rs, Hoisting & Portable Local No. 101*, 3 F.3d 281 (8th Cir. 1993); see Pet. App. 7a.

2. On December 21, 1993, petitioner was paid $150,000 in partial satisfaction of the judgment. Pet. App. 8a. The payment was made by check payable jointly to petitioner and her attorneys. Petitioner received $76,000 of the payment and her attorneys retained $74,000 as legal fees. *Ibid.* On her federal income tax return for 1993, petitioner reported the entire $150,000 payment as "Other income" and reported the

$74,000 in attorney's fees as a miscellaneous itemized deduction. *Ibid.*

The Commissioner issued a deficiency notice to petitioner in the amount of $17,402. Pet. App. 9a. The deficiency resulted from the application of the alternative minimum tax (AMT), which is based on net income calculated without an allowance for various miscellaneous itemized deductions, including attorney's fees. *Ibid.*[1]

Petitioner challenged the deficiency in Tax Court. Petitioner asserted that the portion of the award that was paid to her attorneys pursuant to the contingent fee agreement was not includable in her gross income. The Tax Court concluded, however, that the entire $150,000 was subject to taxation and that the amount paid to her attorneys constituted a miscellaneous itemized deduction. Since a deduction for attorney's fees is disallowed in computing the AMT, the Tax Court upheld the $17,402 deficiency. Pet. App. 17a-18a.

3. The court of appeals affirmed. Pet. App. 1a-5a. The court concluded that the entire amount of the recovery represented gross income to petitioner, for it not only benefitted her directly but also "permitted Petitioner to discharge the personal obligation owed to her attorneys." *Id.* at 3a (citing *Coady* v. *Commissioner*, 213 F.3d 1187, 1191 (9th Cir. 2000); *Baylin* v. *United States*, 43 F.3d 1451, 1454 (Fed. Cir. 1995)). The court further stated that petitioner's assertion (*id.* at 3a):

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[1] Petitioner filed an amended tax return, claiming a refund in the amount of $20,075 on the grounds that the entire amount of her recovery under Title VII was excludable from her income. Pet. App. 2a. The courts below rejected that argument (*id.* at 3a, 9a-13a), and it is not raised in the petition.

that the effect of her contingent fee agreement and the Missouri lien statute alters the analysis is equally unavailing. Petitioner points to rulings in other circuits holding that contingent fees paid directly to attorneys are not taxable income based on the applicable attorney lien statutes. *See, e.g., Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001) (Alabama statute); *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000) (Michigan statute); *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959) (Alabama statute). However, the majority of the circuits have rejected this argument. *See, e.g., Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001) (Wisconsin statute); *Young v. Commissioner*, 240 F.3d 369 (4th Cir. 2001) (North Carolina statute); *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000) (California statute); *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000) (Alaska statute); *Baylin v. U.S.*, 43 F.3d 1451 (Fed. Cir. 1995) (Maryland statute).

Furthermore, the cases Petitioner relies upon are readily distinguished. As the Tax Court correctly noted, the Missouri lien statute, unlike the Alabama and Michigan statutes, does not create a proprietary interest in the recovery on the attorney's behalf. Instead, the Missouri statute simply operates as a manner of ensuring payment to the attorney. As the Seventh Circuit recently observed, an attorney with a lien on settlement "is no different in this respect from any other trade creditor stiffed by his debtor." *Kenseth*, 259 F.3d at 884.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review by this Court is therefore not warranted.

The same question presented in this case was raised, and resolved adversely to the taxpayer, in *Coady* v. *Commissioner*, 213 F.3d 1187 (9th Cir. 2000), and *Benci-Woodward* v. *Commissioner*, 219 F.3d 941 (9th Cir. 2000). This Court denied the taxpayer's petition for a writ of certiorari in *Coady* on April 16, 2001 (532 U.S. 972), and denied the taxpayer's petition for a writ of certioarari in *Benci-Woodward* on January 16, 2001 (531 U.S. 1112). For the same reasons stated in our brief in opposition to the petition for a writ of certiorari in *Benci-Woodward*, the petition for a writ of certiorari should be denied in this case.[2]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 2002

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[2] We are providing herewith to petitioner a copy of the government's brief in opposition to the petition in the *Benci-Woodward* case.

Supreme Court, U.S.
FILED
APR 18 2002
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(3)

No. 01-1348

In the Supreme Court of the United States

NANCY J. HUKKANEN-CAMPBELL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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Srivastava v. Commissioner, 220 F.3d 353 (5th Cir. 2000) 3, 5, 10

Young v. Commissioner, 240 F.3d 369 (4th Cir. 2001) 5, 6

Statutes:

26 U.S.C. § 61(a) 7

26 U.S.C. § 7430 6

26 U.S.C. § 7482(b)(1)(A) 10

Miscellaneous:

Tom Herman, *Tax Report*, WALL ST. J., Aug. 2, 2000, at A1 6

REPLY BRIEF FOR THE PETITIONER

The Commissioner of Internal Revenue asserts that this Court should deny certiorari in this case "[f]or the same reasons stated in [his] brief in opposition to the petition for a writ of certiorari in *Benci-Woodward* [*v. Commissioner*, No. 00-592]." Opp. 5. In his brief in opposition in *Benci-Woodward*, the Commissioner argued that this Court should deny certiorari on essentially the same issue as the one presented by this case because no conflict among the circuits existed. *B-W* Opp. 5-7.[1] This was true, according to his *Benci-Woodward* opposition, because the Ninth Circuit's rejection of the contrary precedent of three other circuits in *Benci-Woodward* was based on differences in State law. *Ibid.*

However, since the filing of the Commissioner's brief in opposition in *Benci-Woodward*, the Ninth Circuit has abandoned the State-by-State approach it applied in that case in favor of a uniform national standard. See *Sinyard v. Commissioner*, 268 F.3d 756, 760 (9th Cir. 2001). Furthermore, during the last year, several other circuit courts of appeals have had the opportunity to decide the issue presented by this case and have uniformly rejected an analysis that depends upon State law and have recognized the split among the circuits. Thus, whatever merit the Commissioner's ground for opposing the *Benci-Woodward* petition may have had at the time of this Court's consideration of that petition, subsequent decisions have established that the Commissioner's argument that no circuit split exists because the Federal tax issue turns on State law is no longer valid.

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1 References to "*B-W* Opp." are to the Commissioner's brief in opposition to the petition in *Benci-Woodward*.

The Tenth Circuit's decision in this case did not rely upon State law, and its holding is in direct conflict with the decisions of the Fifth, Sixth, and Eleventh Circuits. Furthermore, its analysis is inconsistent with this Court's decisions establishing the boundaries of "income" for purposes of the tax law.

I. THE COMMISSIONER'S ASSERTION THAT NO CIRCUIT SPLIT EXISTS BECAUSE EACH CASE TURNS UPON STATE LAW HAS BEEN UNIFORMLY REJECTED.

Since the time of the Commissioner's filing of his opposition to the *Benci-Woodward* petition, which he incorporates by reference in his opposition in this case (at 5), the Ninth Circuit (which decided *Benci-Woodward*), the Tenth Circuit (in this case), other courts of appeals, and commentators have uniformly rejected the premise of the Commissioner's argument, *i.e.* that the conflicting decisions of the various courts of appeals turn upon the State law governing the attorney-client relationship.

A. The Ninth Circuit Has Abandoned Its State-By-State Analysis, Applied In *Benci-Woodward*, In Favor Of A Uniform National Approach Under Which Its Position Is In Conflict With Other Circuits' Decisions.

In his opposition to the *Benci-Woodward* petition, the Commissioner correctly referred this Court to the Ninth Circuit's reliance in that case on differences in State attorney lien laws, which the court used to distinguish the contrary

precedents of the Fifth and Sixth Circuits.[2] *B-W* Op. 6-7, citing *Benci-Woodward*, 219 F.3d at 943. The Ninth Circuit relied heavily on differences in State law in distinguishing those contrary precedents in that case. *Ibid.*

However, in *Sinyard*, decided several months after this Court's consideration of the *Benci-Woodward* petition,[3] the Ninth Circuit reversed course. In *Sinyard*, the court of appeals considered a situation in which the relevant contingent fee contract was governed by Alabama law—the same State law that governed in *Cotnam*. The Ninth Circuit addressed the taxpayer's argument that the rule of *Cotnam* should apply because the Alabama attorney lien statute applied:

> We do not dispute the old Fifth Circuit's statement of Alabama law [as creating a lien on the recovery in favor of the lawyer], but we do not see how the

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2 The contrary decisions of the Fifth and Sixth Circuits distinguished in *Benci-Woodward* were *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), and *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000). The Ninth Circuit's opinion did not cite or address the later decision of the Fifth Circuit, reaffirming its *Cotnam* holding, in *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000), or the Eleventh Circuit's decisions in *Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001), and *Barlow-Davis v. Commissioner*, 210 F.3d 1346 (11th Cir. 2000). *Benci-Woodward*, 219 F.3d at 943.

3 The Ninth Circuit's *Sinyard* decision was also issued several months after this Court's consideration of the petition for a writ of certiorari in *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000), *cert. denied*, 532 U.S. 972 (2001). The Ninth Circuit applied the same State-by-State approach in *Coady* as it did in *Benci-Woodward*—the approach it later repudiated in *Sinyard*.

> existence of a lien in favor of the taxpayer's creditor makes the satisfaction of the debt any less income to the taxpayer whose obligation is satisfied. Like the Tax Court, we decline to follow *Cotnam*.

Sinyard, 268 F.3d at 760. The Ninth Circuit's departure in *Sinyard* from its State-by-State approach of *Benci-Woodward* was confirmed by the dissenting judge. *Sinyard*, 268 F.3d at 761 n.1 (McKeown, J., dissenting) ("The majority appears to conclude that state law is irrelevant to the taxability of a contractually-determined attorney's fee").

With its decision in *Sinyard*, the Ninth Circuit joined other circuits (as discussed in the following subsection) in rejecting an analysis that relies upon differences in State attorney lien statutes. Thus, the Commissioner's assertion in his opposition to the *Benci-Woodward* petition that no circuit split exists because the issue turns on State law is no longer valid. Accordingly, his incorporation of that stale assertion in his opposition to the petition in this case (at 5) is without merit.

B. The Split Among The Circuits On The Federal Income Tax Question Presented By This Case Is Widely Recognized.

The Ninth Circuit is not the only court of appeals that has acknowledged that its precedents are in conflict with those of the Fifth, Sixth, and Eleventh Circuits. The Tenth Circuit itself in this case noted that "the majority of the circuits" have rejected the holdings of the Fifth, Sixth, and Eleventh Circuits, citing the decisions of four circuits. Pet. App. 3a. The Tenth Circuit also "agree[d] with Petitioner that a universal standard independent of the 'intricacies of [an]

attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." Pet. App. 4a, quoting *Srivastava*, 220 F.3d at 364. Thus, the Tenth Circuit's opinion in this case is inconsistent with the borrowed ground for opposition of the petition offered by the government. Compare *B-W* Opp. 6-7, Pet. App. 4a.

As outlined in detail in the petition (at 13-14), other circuits have carefully explained that their decisions do not turn upon differences in State law. Some of these courts of appeals have explained their non-reliance on State law in the time since this Court's consideration of previous petitions for a writ of certiorari[4] on the issue presented in this case. See *Kenseth v. Commissioner*, 259 F.3d 881, 883-884 (7th Cir. 2001) ("There is nothing exotic about this analysis—nothing, indeed, that depends on the particular contractual setting * * * out of which this case arises"); *Young v. Commissioner*, 240 F.3d 369, 378-379 (4th Cir. 2001). In at least one case, the sole question was whether differences in State law justified deviating from circuit precedent. *Srivastava*, 220 F.3d at 357-358 (deciding that any differences in Texas attorney lien statute did not justify departure from *Cotnam*, which involved an attorney-client relationship governed by Alabama law).

As a result of their views that the issue raised by this case does not turn on State law, courts of appeals have often explicitly recognized the split among the circuits.[5] See

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4 The petition in *Benci-Woodward* was denied January 16, 2001 (531 U.S. 1112) and the petition in *Coady* was denied April 16, 2001 (532 U.S. 972).

5 Legal commentators and national media have also drawn attention to the split among the circuits. See Pet. 17 and sources

Kenseth, 259 F.3d at 883 ("The circuits are split on whether a contingent fee is * * * a part of the client's taxable income"); *Young*, 240 F.3d at 379 (joining "the majority of those circuits to have addressed this issue"). The Eleventh Circuit has recognized the split in the course of awarding a taxpayer litigation costs under 26 U.S.C. § 7430, holding that the Commissioner was not "substantially justified" in pursuing his position that contingent attorney's fees constitute income to the successful plaintiff in light of the Eleventh Circuit's clearly-enunciated position on the circuit split, stating:

> In its appeal brief, the government lists the circuits where it is litigating the *Cotnam* issue, and includes a list of circuits where it has won and where it has lost. However, the IRS should not expect the individual taxpayer to fund its crusade to change the law. While other circuits may include contingency fees paid to attorneys in a taxpayer's gross income, *Cotnam* is clearly the law of this circuit.

Foster v. United States, 249 F.3d 1275, 1280-1281 (11th Cir. 2001).

The courts of appeals understand that they are split on the issue presented by this case. The Commissioner's assertions to the contrary should be rejected.

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cited therein; see, *e.g.*, Tom Herman, *Tax Report*, WALL ST. J., Aug. 2, 2000, at A1 (labeling the circuit split on this issue "a confusing jumble that the Supreme Court may have to untangle").

II. THE TENTH CIRCUIT'S DECISION IS INCONSISTENT WITH THIS COURT'S PRECEDENT ON INCOME RECOGNITION.

Our petition (at 18-29) catalogued the various ways in which the Tenth Circuit's analysis in this case deviated from decades of this Court's precedents on the definition of "income" and the application of the "assignment-of-income" doctrine. In response, the Commissioner asserts summarily (at 5) that "[t]he decision of the court of appeals is correct."

Similarly, the Commissioner's opposition in *Benci-Woodward* does not directly refute petitioner's analysis regarding the inconsistencies between the Tenth Circuit's decision and this Court's precedents. In its one paragraph addressing the correctness of the court of appeals' legal analysis, the Commissioner asserted:

> Because petitioners thus retained full ownership of their cause of action, it necessarily follows that the entire amount of the punitive damages awarded to them [including the attorney's fees portion] must be included in their gross income under 26 U.S.C. 61(a).

B-W Opp. 5. In support of this "full ownership" standard, which has no basis in the Internal Revenue Code or judicial analysis, the Commissioner cited only *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). *B-W* Opp. 5.

Legal ownership of income is not the determining factor in analyzing income recognition for tax purposes. The simplest example of this point is the treatment of loan proceeds under the tax law. A borrower who receives funds from a lender has indisputable legal title to the funds

borrowed. Nevertheless, it is established beyond question that a loan does not give rise to income to the borrower because of the obligation to repay. See *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983).

Rather, the test for income recognition established by this Court's precedents is whether the taxpayer has complete dominion and control over the income. See Pet. 18-20; *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 208-210 (1990).

> The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.

Commissioner v. Sunnen, 333 U.S. 591, 604 (1948).

The sole case cited by the government as justifying the Ninth Circuit's decision in *Benci-Woodward*, and presumably therefore the Tenth Circuit's decision in this case, is *Glenshaw Glass*. *B-W* Opp. 5. *Glenshaw Glass* established the now-uncontroversial proposition that punitive damages constitute income to the recipient plaintiff. *Glenshaw Glass*, 348 U.S. at 431-433. Accordingly, and particularly in light of the government's citation of it without further explanation, the relevance of *Glenshaw Glass* to the correctness of the Tenth Circuit's analysis is negligible.

Any relevance that *Glenshaw Glass* has, however, actually supports petitioner's assertion that the Tenth Circuit's analysis is inconsistent with this Court's. In *Glenshaw Glass*, the Court recited the test that petitioner asserts the Tenth

Circuit should have applied: whether the payments at issue are "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.* at 431.

As explained in the petition (at 9-12, 20-22), applying this Court's tests to this case, Ms. Hukkanen did not have the dominion and control over the attorneys' fees portion of the defendant's payment necessary to impute the receipt of taxable income to her. Ms. Hukkanen never had possession of those funds, nor could she ever have disgorged those funds from her attorneys on account of the statutory and contractual lien on the proceeds her attorneys possessed. Ms. Hukkanen had "lost [her] right to receive payment for the lawyer's portion of the judgment." *Estate of Clarks*, 202 F.3d at 856; see also *Cotnam*, 263 F.2d at 126 ("In our opinion, it is as illegal as it is unjust to tax [plaintiff] on [the attorney's fees portion] which did not pass through her hands and of which she never had control"). The value of Ms. Hukkanen's lawsuit "was entirely speculative and dependent on the services of counsel" at the time she retained her attorneys. *Estate of Clarks*, 202 F.3d at 857. Ms. Hukkanen did not possess the necessary dominion and control over the attorneys' fees portion of the lawsuit proceeds, and the Tenth Circuit's holding that those funds represented income to her is in conflict with this Court's precedents.

III. THE CIRCUIT SPLIT ON THE ISSUE RAISED BY THIS CASE LEADS TO ARBITRARY DIFFERENCES IN TAX TREATMENT AND ABSURD RESULTS.

Under the current state of the law, taxpayers who reside in the Fifth, Sixth, or Eleventh Circuits at the time they file a

petition in the Tax Court challenging their tax liability are entitled to exclude the attorney's fee portion of taxable lawsuit recoveries from their income. See Pet. 8 n.6; 26 U.S.C. § 7482(b)(1)(A). Even under the narrow interpretation of those circuits' precedents espoused by the Commissioner in his opposition to the petition (at 5), taxpayers whose relationships with their attorneys are governed by the law of Alabama, Texas, or Michigan can exclude the attorney's fees portion of lawsuit proceeds from their incomes. See *Foster*; *Srivastava*; *Estate of Clarks*.

The Commissioner's position that no circuit split exists because each case turns upon State law, if allowed to stand, would require every circuit court of appeals to determine the legal effect of each State's attorney lien law. That is because there is no necessary correlation between the State law that governs a taxpayer's attorney-client relationship (which the Commissioner asserts controls the tax result) and the circuit in which a taxpayer resides at the time of his filing of a Tax Court petition (which controls the circuit law that applies when the taxpayer litigates his tax liability).

This Court should grant the petition and resolve the split among the circuits to promote uniformity in the application of the Federal income tax laws on this fundamental and recurring issue.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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